CHAPTER 4

FINANCIAL MANAGEMENT

OVERVIEW

This chapter provides information about the financial management of the project including: expenses eligible for reimbursement, eligible match, and what is required to receive your TSEP funds. It also provides details about setting up an accounting system that conforms to generally accepted accounting principles and the audit requirements under state law.

A. APPLICABLE STATE STATUTES

1. Treasure State Endowment Program Authorized (Section 90-6-7, MCA)

   The passage of Legislative Referendum 110, by Montana voters on June 2, 1992, authorized the Treasure State Endowment Program (TSEP).

2. Funding for Projects by the 2003 Legislative Session (House Bill 11)

   House Bill 11 authorized grant funding for 40 local public facility projects through TSEP, with three additional projects authorized if sufficient funds become available.

3. County Water and Sewer Districts and Solid Waste Districts Authorized to Apply for TSEP Assistance (Section 90-6-701(3)(b), MCA)

   This statute authorized county water and sewer districts and solid waste districts to apply for TSEP assistance and authorized MDOC to borrow funds from the Montana Board of Investments to fund the TSEP projects approved in 1993.

4. Tribal Governments Authorized to Apply for TSEP Assistance (Section 90-6-701(3)(b), MCA)

   The 1999 Legislature added tribal governments to the list of eligible applicants that could apply for TSEP assistance.

5. Budgetary, Accounting and Reporting Systems (BARS) for Cities, Counties, Towns and Special Districts (Section 2-7-504, MCA)

   This statute requires all local governments to establish financial management systems that conform to Generally Accepted Accounting Principles (GAAP). The BARS system, required by Montana law, fulfills all GAAP project accounting and reporting requirements (Section 2-7-504, MCA).

6. Appropriation power -- requirements (Section 7-6-4006, MCA)

This statute provides for the appropriation of money and the payment of the debts and expenses of the local government.

7. Surety Bonds

Montana law requires surety bonds for county, city and town officers and employees who are involved in the administration of public funds. The amount of a bond should be based on the amount of money handled and the opportunity for defalcation (Sections 2-9-701, 2-9-702 and 2-9-802, MCA).

Under Montana law, performance bonds for county water and sewer district administrative personnel is discretionary (Section 7-13-2279, MCA). The law is silent on performance bond requirements for solid waste district personnel.

B. TSEP REQUIREMENTS

1. Project Budget

The project budget is part of the TSEP contract. Before TSEP funds can actually be provided to a local government, there are specific requirements related to the project budget that must be met by the TSEP recipient.

a. **The TSEP recipient must appropriate, by resolution, the grant or loan money received from MDOC.** The resolution must state the source of the money, the program in which money will be expended and the effective date of the resolution. If the TSEP funds have been appropriated as part of the annual budget process, a separate resolution is not required. (See Exhibit 4-A for a sample budgetary resolution format.)

b. The TSEP recipient must expend the grant money in accordance with the provisions of the project budget. However, the TSEP portion of the project budget may be amended so long as it is not increased and does not violate the conditions under which the grant money was awarded. The TSEP recipient must request approval for all budget amendments from MDOC. **Any budget amendment that is $5,000 or more must be approved in advance. Budget amendments under $5,000 can be submitted with a drawdown request. Upon approval of the request, the TSEP recipient is required to pass a**

new resolution showing the amended project budget.

The preparation, content and approval of the project budget is dealt with in Chapter 1, as well as issues related to amending budgets or contracts. Please consult Chapter 1 for related information.

2. Project Expenses Eligible for Reimbursement

Eligible project expenses that can be reimbursed with TSEP funds, are those reasonable expenses incurred after a TSEP contract has been signed, that directly relate to the planning, design, construction, erection, acquisition, site or other improvements, alteration, modernization, reconstruction, or expansion of the infrastructure type projects listed below:

a. Drinking water systems;

b. Wastewater treatment;

c. Sanitary sewer or storm sewer systems;

d. Solid waste disposal and separation systems, including site acquisition, preparation or monitoring; or

e. Bridges.

Some specific project expenses that are also eligible for reimbursement with TSEP funds include: connection charges (hook-up fees and connection costs), water meters, and meter installation.

Only those project expenses that have been incurred after a TSEP contract has been signed are eligible for reimbursement with TSEP funding. However, reasonable expenses incurred attending the TSEP Project Administration Workshop are also eligible for reimbursement, even though they may have been incurred prior to a TSEP contract being signed. If the local government has contracted with a consultant to administer the grant and the consultant is also going to administer other TSEP grants, the consultant must proportionately allocate the cost of attending the workshop between the projects being represented.

Administration expenses are also eligible for reimbursement as long as they are reasonable and appropriate administrative and financial costs that are attributable to a TSEP project.

The purchase of computer software, that is necessary to utilize the various TSEP forms and spreadsheets on a computer, is an eligible administration cost. In addition, TSEP will also allow computer hardware as an eligible administration cost if it is required to run the software or needed to otherwise manage the TSEP project; however, MDOC will only reimburse up to 50% of the cost of the computer or computer software.

Project administration costs must be accounted for on a direct cost basis. Direct costs are those costs that can be identified specifically with a particular cost objective (a specific cost center established to record the accumulation of costs). Direct administration costs that may be eligible for reimbursement are those costs that can be associated directly with the project. For instance, compensation of employees working directly on the project, or auditing expenses directly related to the project, may be eligible for reimbursement. However, the TSEP recipient must be able to adequately document that the costs are directly associated with the project, such as with employee timesheets showing hours spent working on the project.

In-direct costs are not eligible project costs. An example of an indirect cost would be claiming a personnel expense based on a fixed percent of an employee's time or pay, which may or may not reflect the actual hours worked on the project. A timesheet reporting actual hours spent working on the project is required to make this claim eligible for reimbursement.

Bond issuance costs and bond interest costs that are attributable to a TSEP project are also an eligible administration/financial expense. However, under current accounting standards, such bond-related costs may require special accounting treatment. For example:

? Bond Issuance Costs -

For governmental funds, bond issuance costs are recognized in the current period. However, significant bond issue costs for enterprise funds should be recorded as deferred charges and amortized over the life of the issue. (For a complete discussion on the subject, including illustrative examples, please refer to pages D-32 to D-36 of the (LGS) Accounting Policies.)

? Bond Interest Costs -

When a local government chooses to construct a fixed asset, a primary accounting consideration is determining the capitalized costs associated with the construction. Capitalized costs are those costs associated with the project that will be treated as an asset. Traditionally, capitalized costs have not included interest costs. In accounting, the issue of whether to expense or capitalize an outlay is resolved by using the "principle of materiality," which suggests that any outlays deemed material (i.e. large) relative to the total cost of the construction project should be capitalized. Therefore, the capitalization of interest is required during the construction phase for qualifying assets if its effect, compared with the effect of expensing interest is material. If the net effect is not material, then interest capitalization is not required.

This accounting standard applies to all enterprise funds. The application of this standard to assets that are reported in the General Fixed Assets Account Group (GFAAG) appears optional. However, it left open the question of interest capitalization <u>when capital project's funds are used for construction undertaken on behalf of an enterprise fund</u>. (For a complete discussion on the subject, including illustrative examples, please refer to pages B-6 and 7 and D-23 to D-27 of the Accounting Policies Manual, provided by the Local Government Services Bureau, Montana Department of Administration.)

3. <u>Ineligible Expenses</u>

Project expenses that cannot be reimbursed with TSEP funds include:

a. Direct financial assistance for religious, charitable, industrial, educational, or benevolent purposes to any private individual, private association, or private corporation not under the control of the state;

b. Annual operation and maintenance;

c. Purchase of non-permanent furnishings and fixtures or equipment that is not permanently installed in and solely dedicated to the operation of a public facility. However, as discussed earlier, a portion of the cost to purchase a computer and the required software may be considered an eligible cost, even though it may be used for general governmental operations;

d. Refinancing existing debt, except when required in conjunction with the financing of a new TSEP project; and

e. **Any unauthorized costs incurred prior to a signed TSEP contract between the TSEP recipient and MDOC.**

4. <u>Eligibility of Matching Funds</u>

Matching funds must be provided by the applicant to assist in financing the total project cost. "Matching Funds" are public or private funds to be provided by a TSEP applicant to directly support the costs of eligible project activities.

Eligible types of matching funds include:

a. local general funds or other cash;

b. proceeds from the sale of general obligation, revenue, special assessment or other bonds;

c. entitlement or formula-based federal or state funds such as federal highway funds or payments in lieu of taxes;

d. loan or grant funds from a state or federal program (including TSEP loans);

e. funds expended for engineering studies, reports, and plans, or other reasonable expenses expended for the preparation of the application, directly related to the proposed project during the period 24 months prior to the TSEP application deadline, i.e., May 5, 2000 to May 4, 2002;

f. funds expended after the TSEP application deadline, May 4, 2002, for project management, final engineering design, and other reasonable expenses necessary to prepare the project as proposed in the TSEP application for the construction phase;

g. the value of land or materials provided by the applicant, if appraised within a two-year period preceding the application deadline. The appraisal must be:

   (i) an impartially written statement that adequately describes the land or materials, and states an opinion of defined value as of a specific date;

   (ii) supported by an analysis of relevant market information; and

   (iii) prepared by a qualified appraiser independent from the applicant.

h. the value of labor performed by the applicant's employees on the proposed project, after the TSEP project has been approved for funding and a TSEP contract has been signed, as long as the employee is paid at his or her standard hourly rate of pay and the time worked is adequately documented; and

i. the value of machinery used in the process of constructing the project that is owned (or leased) and operated by the applicant. The value of the use of the machinery will be determined using the Federal Emergency Management Agency (FEMA) equipment rate schedules.

Ineligible matching funds include:

a. Land, materials or services that cannot accurately and fairly be assigned a uniform monetary value.

b. Funds expended on a project before it is approved for funding by the Legislature and Governor except as noted above.

5. Depository for Project Funds

TSEP grant and/or loan funds received by the TSEP recipient must be deposited in a bank depository, however, they do not have to be deposited into a bank depository separate from the recipient's regular bank account. They may be placed in any one of the TSEP recipient's common treasury depositories. However, **TSEP funds must be accounted for in a separate project cash account within the appropriate fund type's set of self-balancing accounts**.

6. Disbursement of TSEP Grant Funds

TSEP funds are appropriated by the Montana Legislature for a two-year period or "biennium." Local governments approved for TSEP funding are funded with revenues obtained from the interest earned on the Treasure State Endowment Fund during the biennium. **TSEP recipients that are guaranteed funding must meet the start-up requirements prior to the end of the biennium in order to maintain that guarantee.** If a TSEP recipient with guaranteed funding meets the start-up requirements prior to the end of the biennium, and there are insufficient TSEP revenues during the biennium, the TSEP recipient will be funded from revenues from the next biennium. **TSEP recipients that do not complete their project start-up requirements before the end of the biennium could risk the possibility that they may not receive TSEP funds if revenues fall below projections during the biennium.**

HB 11 authorizes some projects for TSEP funding, but only if sufficient TSEP funds become available. It there are insufficient TSEP revenues during the biennium, those projects are not funded and are required to re-apply to the next Legislature for funding.

Because TSEP funds accumulate gradually as interest is earned on the Treasure State Endowment Fund over the two-year biennium period, sufficient funds are not always available to fund projects when local officials are ready to proceed. However, **TSEP**

funds are generally made available at the beginning of each month to projects that have completed the start-up requirements. A "notice to proceed" letter will be sent notifying the local government that start-up requirements have been satisfied, TSEP funds are available, and it can begin to draw down TSEP funds.

The start-up requirements include:

a. Contract -- A contract has been signed between MDOC and the TSEP recipient. The contract must include the scope of work and a budget that describes how TSEP funds will be spent. The contract must also include a preliminary implementation schedule that describes when the different tasks of the project will take place. The scope of work, budget and implementation schedule must be approved by MDOC.

b. Management Plan -- The TSEP recipient has prepared a management plan detailing which individuals will be responsible for various management activities and MDOC has approved the plan.

c. In compliance with the auditing and reporting requirements -- The TSEP recipient is in compliance with the auditing and reporting requirements provided for in 2-7-503, and has established a financial accounting system that the department can reasonably ensure conforms to generally accepted accounting principles. Tribal governments must comply with auditing and reporting requirements provided for in OMB Circular A-133 instead of 2-7-503.

d. Firm Written Commitment of Matching Funds -- The TSEP recipient has obtained a firm written commitment from the appropriate funding agency clearly stating that local and other matching funds are immediately available, and the commitment has been approved by MDOC.

e. Special Conditions -- The TSEP recipient has complied with any additional start-up requirements that were approved by the Legislature.

However, if the level of TSEP revenues used to pay project expenses becomes too low, MDOC may require projects that have met start-up requirements to wait until there are sufficient revenues again. In that case, MDOC will always start at the top of the priority ranking list as approved by the Legislature in order to offer available TSEP funds to the highest ranked projects that are ready to proceed. As a result, a project may be temporarily passed over for funding because the project had not completed start-up requirements, but this does not affect the project's eligibility to receive funds at a later date. Projects that have met start-up requirements and that are temporarily passed over for funding will have the opportunity to receive TSEP funding as revenues become available.

7. Project Drawdown Requests and Quarterly Reporting

The Request for Funds Form is used by TSEP recipient's to request TSEP funds for reimbursement of eligible project costs. The Project Progress Report is used by TSEP recipients both when requesting TSEP funds and when filing quarterly reports. The format and content of the TSEP Project Progress Report is described in Exhibit 4-C. Exhibit 4-D shows an example of a completed TSEP Project Progress Report.

a. Request For Funds Form

TSEP recipients can initiate a request for TSEP funds by preparing and submitting the Request for Funds Form (Exhibit 4-B). A computer-generated report is also acceptable, so long as it contains the same information as the preprinted form. **Each request for TSEP funds must also be accompanied by a Project Progress Report** (Exhibit 4-C) which will provide MDOC with information on the use of the funds requested and the progress and status of the project. In addition, the TSEP recipient may need to provide additional documentation to support their claim for expenses to be reimbursed. A checklist is provided to ensure that the TSEP recipient has taken the proper steps necessary to process a request for funds (Exhibit 4-F).

The Request for Funds Form and accompanying Project Progress Report may be mailed to your TSEP staff liaison at the Department of Commerce, CDD/TSEP, 301 South Park Avenue, PO Box 200523, Helena, MT 59620-0523.

Upon receipt, the TSEP staff liaison for your project will review your request to ensure that the form is properly completed and all of the accompanying attachments have been included.

(1) **In addition to submitting the Request For Funds Form and the Project Progress Report, the TSEP recipient must provide the following supporting documentation:**

(a) **A copy of the Uniform Status of Funds Spreadsheet showing the current budget for the project and status of all funds involved in the project.** (See Exhibit 4-G for the spreadsheet and instructions on how to use it, and Exhibit 4-H for a sample of a completed spreadsheet.)

(b) **A current copy of the Uniform Invoice Tracking Spreadsheet**

showing invoices received to date. (See Exhibit 4-I for the spreadsheet and instructions on how to use it, and Exhibit 4-J for a sample of a completed spreadsheet.) Once a page(s) is complete it does not need to be submitted again unless requested.

> The TSEP recipient has the option of using the invoice tracking spreadsheet to record all invoices, which will make the spreadsheet reconcilable to the status of funds spreadsheet and other accounting records. **At a minimum, the TSEP recipient must record all invoices from a consultant grant administrator, project engineer and construction contractor**.

(c) **Copies of invoices, purchase orders, lease agreements, acquisition agreements, etc, when the amount of the TSEP portion of each individual expenditure is $5,000 or more.** <u>All</u> expenditures that have been paid in part or totally from TSEP funds, regardless of the amount, must be itemized in the Project Progress Report.

> All invoices from contractors providing professional services, such as grant administrators and engineers, must itemize the work performed and include a narrative description in sufficient detail to justify the amount claimed. At a minimum, the contractor must include an itemized description of work performed, number of hours worked to accomplish each item, the amount being billed for each item, a description of any other eligible expenses incurred during the billing period and the total amount being billed.

(d) **Completed Certification of Labor Compliance form**. Form must be completed for any request of funds relating to construction contracts. See Exhibit 4-K for a copy of the form.

(e) Copies of timesheets or other summary payroll information for work performed by city or county employees. Summary information must include at a minimum the name, title, time period, activities performed, and total amount.

(f) If the TSEP liaison has any questions concerning the appropriateness or amount of an expenditure, copies of more detailed supporting documentation may be required.

(2) The TSEP recipient can only be reimbursed for project costs that have actually been incurred.

(3) If the TSEP recipient is constructing multiple unrelated projects at the same time using a single contractor, the invoice and related documentation submitted with the Request for Funds Form must be separate from the other project(s) so that the claim is clearly distinct for the project funded by TSEP funds. For example, a city is constructing both a water and sewer project using the same contractor, and only the sewer project is being funded in part by TSEP funds, the city must provide an invoice showing expenses just for the sewer project. Expenses for the water project must be on a separate invoice.

(4) The TSEP staff will review both the Request For Funds Form and the Project Progress Report and check:

(a) The contract number, addresses and bank account number for correctness;

(b) The reasonableness of the amount requested. Expenditures must be appropriate based upon the description offered for both administration and project activity costs. The amount requested must be consistent with the approved contract budget and the project progress report;

(c) The eligibility of all costs and their consistency with the contract scope of services;

(d) Financial numbers for correctness;

(e) The expended to date balances for consistency with the preceding request for payment;

(f) The percentage of the administration and activity budgets expended, the total amount drawn to date against the amount budgeted and the amount of TSEP funds on hand; and

(g) Correctness of signatures against the authorized signature form.

(5) If the information is satisfactory, the TSEP staff will sign the request.

(6) If the information is unsatisfactory, the TSEP recipient will be notified of any deficiencies. Depending on the nature of the deficiencies, the TSEP recipient may be required to submit a new request.

Once the request for payment is approved, the TSEP funds will be sent directly to the TSEP recipient's bank depository. The turn-around time for receipt of funds may be up to fifteen (15) working days after receiving a satisfactory drawdown request.

To expedite routine drawdowns, the TSEP recipient should consider the use of a master form in the preparation of the Request for Funds Form. The master would be headed up with only that information which is fixed and must appear on every drawdown. It is then just a matter of taking a photocopy of the master each time and entering the information that pertains to the current drawdown. Standard information is not repeated for each drawdown and a new master would only have to be prepared in the case of budget amendments.

b. Quarterly Reporting Requirements

The TSEP recipient is required to submit a Project Progress Report each calendar year quarter unless the TSEP recipient has submitted a request for funds to TSEP at some point during the quarter. The Project Progress Report is required within fifteen (15) days following the close of each quarter. When the TSEP recipient is submitting a Project Progress Report to satisfy the quarterly report requirement, the TSEP recipient only needs to include an update to the project status section of the Project Progress Report.

c. Retainage

The Department will retain two percent (2%) of the total authorized grant amount until:

- **the project has been completed (a Certificate of Substantial Completion has been issued), and**
- **a conditional closeout report has been submitted by the TSEP recipient and approved by the Department.**

This amount will be withheld at the end of the project as compared to each request for funds. Once a conditional closeout has been submitted and approved by the Department, the two percent (2%) retainage will be released to the TSEP recipient. For more information on the release of the retained funds at closeout, refer to Chapter 11-Project Closeout.

In special cases, a portion or all of the retainage may be released to the TSEP recipient prior to a conditional closeout. This provision will only be permitted at the discretion of the TSEP staff when there are extenuating circumstances that would cause undue hardship on the TSEP recipient and MDOC can be assured that the project will be completed.

8. Interim Financing

In some cases, the TSEP recipient may need or want to secure other financing in the interim before TSEP funds become available for release. Local governments that wish to commence work on their projects before TSEP funds are available may arrange interim financing from another funding source. When TSEP funds become available, they can be used to repay the interim loan. However, a local government that obtains interim financing does so at its own risk of a shortfall of TSEP funds. **Before arranging interim financing and incurring any costs, the TSEP recipient should first consult with the TSEP liaison.**

TSEP recipients have the following discretionary interim financing options:

a. Under Attorney General Opinion Number 14, Volume 38, they may borrow money directly from a financial institution.

b. Under Section 7-7-109, MCA, they may sell notes in anticipation of receiving a grant or loan from federal or state sources.

c. Under Sections 7-6-2603 (counties) and 7-6-4501 (cities and towns), MCA, they may issue warrants and register them, a form of borrowing, with a bank, once spending authority has been approved.

d. Under Sections 7-6-2701 (counties) and 7-6-4603 (cities and towns), MCA, they may invest in the warrants issued in "c" above, subject to the availability of money in the fund from which the investment would be made. This has the effect of an interfund loan.

e. Under Sections 7-13-2221 (county water and sewer districts) and 7-13-236 (solid waste districts), they may borrow money, in addition to the issuance of bonds, for construction purposes and the purchase of equipment.

9. Retention of Documents, Records and Reports

The following types of documents, records and reports must be retained for three years after project closeout. However, in the event of litigation, claims, audit or other action, such documents, records and reports must be retained until completion of the action or regular time period, whichever is later.

a. Documents:

(1) Receipts
(2) Purchase orders
(3) Expenditure reviews
(4) Invoice/statements
(5) Claims
(6) Checks
(7) Warrants

b. Records:

(1) Accounting
(2) Budgetary
(3) Payroll
(4) Time Sheets
(5) Bank statements

c. Reports:

(1) Financial statements/monthly and annual
(2) Budgetary/monthly and annual
(3) Payroll
(4) Requests For Funds and/or Quarterly Project Progress Reports
(5) Payment Certifications

d. Other:

(1) Budgetary Resolutions
(2) Signature Certifications
(3) Designations of Depository

These documents, records and reports are subject to applicable state laws and local requirements relating to public access, privacy and confidentiality.

10. Project Monitoring

Recipients of TSEP financial assistance are responsible for administering their TSEP projects in accordance with all applicable state statutory and regulatory requirements, unless they are superseded by federal requirements. The Department has the responsibility to ensure that TSEP recipients are carrying out their projects in accordance with these requirements.

Project monitoring is the Department's primary method for determining whether a project is in compliance with the state laws and TSEP requirements. Consequently,

TSEP staff will periodically make on-site monitoring visits to ensure that TSEP funds are properly used and accounted for and that the projects are being administered in conformance with state laws and regulations. Chapter 10, Project Monitoring, discusses TSEP monitoring procedures in more detail.

C. GENERAL ACCOUNTING REQUIREMENTS

The Local Government Services Bureau referenced in the remainder of this chapter is located in the Department of Administration.

1. Standards For Accounting Systems

The TSEP recipient is required to be in compliance with the auditing and reporting requirements provided for in 2-7-503, MCA, and have established a financial accounting system that the department can reasonably ensure conforms to generally accepted accounting principles (GAAP). Tribal governments must comply with auditing and reporting requirements provided for in OMB Circular A-133 instead of 2-7-503, MCA.

In order to ensure compliance, MDOC relies upon the Local Government Services Bureau to confirm that the local government appears to be in compliance with GAAP requirements. The Local Government Services Bureau is also available at no charge to the TSEP recipient to help set up an accounting system. The Local Government Services Bureau will not call upon a local government to help it with accounting problems or to verify compliance with GAAP unless requested by the local government. **As a result, the local government will be required to request an on-site visit unless the Local Government Services Bureau can confirm by telephone that the local government appears to be in compliance with GAAP requirements without an on-site visit.**

For new water, wastewater and solid waste districts with no existing accounting system, the TSEP recipient will initially be required to set up an accounting system that can account for expenses related to the project. However, before the TSEP recipient can conditionally closeout the project, a complete accounting system that can account for the operational needs of the system must be in place.

2. Fund Accounting

Accountability for TSEP funds requires adequate assurance that these funds are used solely for authorized purposes, a requirement that is best met through fund accounting. Fund accounting is a control device to segregate resources and ensure that the segregated resources are only used for their intended purposes.

TSEP recipient accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

Governmental accounting standards require that local governments use a fund accounting system. The Montana Bars System for Counties, Cities and Towns, and Special Districts is a fund accounting system that meets all fund accounting requirements.

3. Fund Type and Account Group to be Utilized

There are a number of funds and account groups that are required to be utilized in a fund accounting system, each depending on the financial situation. However, the TSEP recipient need only be concerned with the following fund types and account group:

a. Capital Projects Funds

Used to account for non-enterprise capital asset resources in the construction of bridges and storm drainage systems.

b. General Fixed Asset Account Group

Used to account for non-enterprise capital assets; bridges and storm drainage systems. (If the TSEP recipient elects to capitalize infrastructure fixed assets of governmental funds.)

c. Enterprise Funds

Used to account for capital asset resources in the construction of water, sewer or solid waste systems.

The above funds and account group will each be structured with a set of self-balancing accounts, in which to record all appropriate TSEP financial transactions.

4. Basis Of Accounting

"Basis of Accounting" is a term used to refer to when revenues and expenditures/expenses, and the related assets and liabilities, are recognized in the accounts and reported in the financial statements.

There are three fundamental accounting bases used to account for transactions, the cash basis, the accrual basis and the modified accrual basis. The basis for Capital Projects Funds is the modified accrual basis. For Enterprise Funds, it's the accrual basis.

Under the modified accrual basis, revenues are recognized when they become susceptible to accrual; that is when they become both "measurable" and "available" to finance expenditures of the current period. Available means collectible in the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures are recognized when the fund liability is incurred.

Under the accrual basis, revenues are recognized when they are earned and become measurable and expenses recognized in the period incurred, if measurable.

5. Fund and Account Structure

The chart of accounts is the framework around which the accounting system is built. A chart of accounts is merely a numerical coding system that permits identification of individual accounts. It also simplifies the referencing of entries on documents and records and helps reflect account relationships.

The coding system that follows is consistent with TSEP needs and is made up of fund identifiers, and balance sheet, revenue and expenditure accounts.

a. Fund Code Identifiers

The fund code identifiers assigned to the required TSEP funds are:

	FUND	FUND/RANGE
(1)	Capital Projects Funds For non-enterprise public facility projects	4300-4399
(2)	General Fixed Asset Account Group For capital projects funds assets *(where you book a bridge, water treatment plant, etc. once completed)*	9000
(3)	Enterprise Funds For public facility projects:	

Water	5210
Sewer	5310
Solid Waste	5410

b. Balance Sheet Accounts

Balance sheet accounts are those accounts that remain open after the books have been closed at year-end, the balances of which are carried forward into the succeeding year. When properly classified, these accounts form the basis for the balance sheet. Simply put, the balance sheet purports to exhibit what a fund owns in the form of assets and what a fund owes in the form of liabilities, the net result of which (assets minus liabilities) is equity.

(1) The general ledger balance sheet accounts applicable to Public Facility Projects (Capital Projects Funds) are:

Account Number	Account Name
101000	Cash
172000	Revenue Control
201100	Warrants Payable
202100	Accounts Payable
242000	Expenditure Control
271000	Fund Balance

(2) The general ledger balance sheet accounts applicable to the General Fixed Asset Account Group (Capital Projects Funds Assets) are:

Account Number	Account Name
181000	Land
182000	Buildings
184000	Improvements other than Buildings
186000	Machinery and Equipment
188000	Construction Work in Progress
286000	Investment in General Fixed Assets-State Grants

(3) The general ledger balance sheet accounts applicable to public facility projects (Enterprise Funds) are:

Account Number	Account Name

1021xx	Cash
172000	Revenue Control
188000	Construction Work in Progress
189xxx	Treatment Plant
189xxx	Utility Plant
189xxx	Allowance for Depreciation
201100	Warrants Payable
202100	Accounts Payable
204000	Loans Payable (short term)
235000	Loans Payable (long term)
242000	Expenditure Control
250700	Reserve for Construction
2601xx	Contributed Capital
272000	Unreserved Retained Earnings

c. Revenue Accounts

Revenues should be classified by source. The primary functions of revenue accounts are to provide a means for verifying the receipt of revenues and to furnish information for preparing financial reports. Revenue accounts are closed out at year-end.

The revenue accounts applicable to Public Facility Projects (Capital Projects Funds and Enterprise Funds) are:

Account Number	Account Name
331xxx	Federal Grants/Loans
334120	Treasure State Endowment Program
334xxx	Other State Grants/Loans
362000	Miscellaneous

d. Expenditure Accounts

Expenditures should be classified by function, activity and object. The function classification provides information on the overall purposes or objectives of expenditures. The activity classification provides information according to the specific types of work performed by the organizational unit. And the object classification relates to the article purchased or service obtained. The primary functions of expenditure accounts are to provide proper control and furnish information for preparing financial reports. Expenditure accounts are closed out at year-end.

The expenditure accounts applicable to Public Facility Projects (Capital Projects Funds and Enterprise Funds) are:

Account Number	Account Name		
470400	Infrastructure		
(the first two numbers "47" tells you it's a public works project)			
	470410	Administration	
		100	Personal Services
		200	Supplies
		310	Postage
		320	Printing/Duplicating
		330	Advertising/Publications
		340	Telephone
		350	Legal
		351	Accounting/Auditing
		352	Consulting
		353	LGS Technical Assistance
		370	Travel/Training
		800	Other
	470420-9xx	Acquisition	
	470430-9xx	Engineering/Arch. Services	
	470440-9xx	Construction	
	470450-9xx	Other	

Optional Treatment Of Certain Enterprise Fund Transactions

The proceeds from capital grants and loans, etc., may be treated as revenue on an interim basis during the fiscal year. And, similarly, the payments made for capital outlay and the principal portion of debt service, etc., may be treated as an expense on an interim basis during the fiscal year. This departure provides a level of simplicity and a visibility of transactions on interim reports that otherwise would not occur.

At year-end, the respective accounts must be closed out so that all accounts are reflected properly in the general accounting records.

6. Fixed Asset Accounting

"Fixed assets" are long-lived tangible assets obtained or controlled as a result of past transactions, events or circumstances. Fixed assets may include buildings, equipment, or improvements other than buildings and land.

They are acquired with cash or cash in conjunction with a trade-in, constructed, and acquired through lease agreement, grant, gift, or donation. Fixed assets acquired should be recorded at historic cost, or if not practically determinable, at estimated historic cost. Donated fixed assets should be recorded at their fair market value when received.

The cost of a fixed asset should include not only its purchase price or construction cost, but also any other reasonable and necessary costs incurred to place the asset in its intended location or use. Such costs could include the following:

? Administration fees/costs

? Legal and title fees

? Appraisal or negotiation fees

? Damage payments

? Transportation charges

? Insurance premiums during construction

? Demolition costs

? Architect and accounting fees

? Site preparation costs

? Interest costs during construction

? Surveying fees

a. Governmental Funds

Generally accepted accounting principles require that fixed assets of a government not reported in a proprietary fund or a trust fund be reported in a General Fixed Assets Account Group (GFAAG). This account group is not a fund; it does not have a balance sheet as such, nor does it report operations. Instead, the GFAAG serves as a list of the government's fixed assets and is designed to ensure accountability. Because the account group does not report operations, all additions and deletions to the GFAAG should be recorded by direct adjustment to the accounts appearing on the entity's combined balance sheet.

<u>The Governmental Accounting Standards Board (GASB) specifically allows governments the option of not reporting infrastructure fixed assets in the GFAAG.</u> By definition, infrastructure assets are immovable and of value only to the governmental unit (sidewalks, gutters, bridges). Therefore, some have argued that there is less need for an accountability listing of such assets because the risk of their being lost or stolen is considerably less than that of other fixed assets. Such an argument, however, fails to take into account the potential losses that can result from poor maintenance or general neglect. Under GASB Pronouncement 34, however, infrastructure will be required to be reported at

years ending after June 15, 2003.

The assets reported in the GFAAG normally are presented by class (land, buildings, improvements other than buildings, equipment). The total amount of these assets is offset by investment in general fixed asset accounts that normally provide details on the source of funding for these assets (other governments, individuals, capital projects, grants). The Investment in General Fixed Assets Account is presented as another credit with a local government's equity accounts.

Because an account group does not report operations, no charge for depreciation can be reported in the account group. Therefore, assets reported in the GFAAG normally continue to be reported at their original cost until disposal. However, Generally Accepted Accounting Principles (GAAP) provides the option of reporting accumulated depreciation on these assets. Because no charge for depreciation can be reported, this account is established by directly reducing the investment in the general fixed asset account and crediting accumulated depreciation for the same amount. (Governmental Accounting, Auditing and Financial Reporting (GAAFR), and Government Fixed Asset Inventory Systems. Published by the Government Officers Association, 180 Michigan Avenue, Suite 800, Chicago, IL 60601-7476.)

b. Enterprise Funds

Enterprise fixed assets are not recorded in the GFAAG. Instead, they are accounted for as fund assets of the enterprise itself. The treatment differs because enterprise fixed assets are utilized in revenue producing activities, and the performance measure of an enterprise is the periodic determination of net income. In the net income determination process, GAAP requires a proper matching of all costs associated with the production of revenues. Depreciation of fixed assets used in the production of revenues is a proper element of such costs. Therefore, enterprise fixed assets are to be capitalized and depreciated in the fund generating the revenues.

"Depreciation" is the expiration in the service life of fixed assets, except land, attributable to wear and tear, deterioration, action of the physical elements, inadequacy and obsolescence. Depreciation is a rational and systematic method of distributing the cost of a capital asset over its estimated service life.

Depreciation is an important element in the income determination process of an enterprise. The method used to allocate the cost of a capital asset over its estimated service life should be as equitable as possible to the periods in which services are obtained from the use of the asset. By far, the most common approach used in practice is the straight-line method.

The straight-line method of depreciation simply requires that the cost of the fixed asset (less projected salvage value) be divided by the number of years of estimated service life to arrive at the annual depreciation charge. Estimated service life is the length of time a fixed asset can be expected to perform the function for which it was intended.

c. Fixed Asset Policy Guidelines

Inadequate fixed asset records continue to be one of the major causes of deficiencies in most local government's financial statements. Failure to maintain a fixed asset system usually results in a qualification in the independent auditor's report (opinion) on the government.

On the other hand, an adequate fixed asset system can result in measurable benefits that provide:

(1) Conformity with generally accepted accounting principles;

(2) Reliable information about fixed assets now owned. Because capital budgets are best developed on a long-term basis, such information is invaluable in projecting future requirements;

(3) Assistance in maintaining accountability for the custody of individual items and in determining who is responsible for their care and maintenance;

(4) Information necessary to perform regular inventories to determine physical condition, theft, or unauthorized transfers;

(5) The ability to identify worn out or obsolete equipment on a concurrent basis. Provision for replacement can be included in a budget before emergency replacement or unwarranted repairs are necessary;

(6) A basis for adequate insurance coverage on insurable fixed assets. Although cost is not the only determinant of insurable value, it could be a necessary consideration; and

(7) Property records that furnish information about the investment taxpayers have made for the future benefit to users of government policy.

A number of critical decisions must be made, however, before an adequate fixed asset policy can be established and implemented. Some of those decisions are:

(1) Which asset types should be included? For example, should the infrastructure general fixed assets be included in the system?

(2) Which assets should be accounted for individually and which should be grouped? For example, should the cost of a fire engine include hoses, ladders, and other associated equipment?

(3) What should the capitalization policy be? This sets the requirements for minimum costs to be accounted for and useful lives.

(4) What are the expected useful lives for the different kinds of fixed assets?

(5) What depreciation method is best? Should the government accumulate depreciation on general fixed assets?

(6) When should depreciation begin for assets acquired during the year? For example, depreciation can begin the month the asset is put into service, or a full year's depreciation can be reported for assets received in the first six months and none for those received during the balance of the year. Still, other governments use the half-year convention where fifty percent of the year's depreciation is taken in the year of addition and in the year of disposition.

(7) What information is needed to begin and maintain the system? Determine data base requirements, the coding system and required reports.

(8) What forms are needed to secure the required information? Their design must ensure complete information and efficient processing.

(9) How will the system be established? A work plan should fix responsibility and establish time estimates. In particular, the initial inventory must be planned thoroughly.

(10) What other policy decision should be established? All policy decisions should be made before beginning work on the fixed asset system. This includes all aspects of the remaining steps -- assigning carrying values and maintaining the system.

A critical step in establishing a fixed asset accounting and reporting system is to establish procedures that will keep the records current. All previous efforts will become outdated and useless unless the information can be updated.

7. <u>Basic Accounting Records</u>

The books of accounts maintained are assumed to be on the double entry system. A double-entry system is defined as a system which requires for every entry made to the debit side of an account(s), an entry for a corresponding amount(s) be made to the credit side of another account(s).

The records required to account for TSEP funds are of two types: the books of original entry and the books of final entry. The books of original entry are those records in which transactions are recorded for the first time, i.e., the Cash Receipts Journal, the Cash Disbursement Journal and the General Journal Voucher. The books of final entry are the summary records in which accounting information is accumulated for financial reporting, i.e., the General Ledger. In an automated environment, however, a single transaction may be recorded simultaneously in the books of original entry and in the books of final entry.

The required books of original and final entry are described below.

? **Cash Receipts Journal**

All cash received is recorded in this book of original entry.

? **Cash Disbursement Journal**

All cash disbursed is recorded in this book of original entry.

? **General Journal Voucher** *(used to correct errors)*

All transactions in place of, or supplemental to, the regular journals are recorded in this book of original entry. The voucher is a substitute for maintaining a formal General Journal.

? **General Ledger** *(should be self-balancing)*

The General Ledger is the book of final entry, where all summarized journal transactions are posted. It contains the accounts needed to present, after closing, the financial representations of the organizational unit.

It is virtually impossible to discuss the books of original entry without discussing their relationship to source documents. Specifically, source documents are documents upon which evidence of an accounting transaction is initially recorded. They may be internally or externally created and are used as the source of entry and support to the various books of original entry. Examples of source documents are general receipts, purchase orders, invoices, claims, payroll time records, contracts, etc.

8. Financial Reports

The financial statements of the TSEP recipient must present fairly its financial position and results of operations in accordance with generally accepted accounting principles, and include the following:

a. The Combined and Combining Balance Sheets - All Fund Types;

b. The Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental Fund types;

c. The Combined and Combining Statement of Revenues, Expenditures and Changes in Fund Balances, Budget and Actual - All Governmental Fund types;

d. The Combined Statement of Revenues, Expenses, and Changes in Retained Earnings - All Proprietary Fund Types;

e. The Combined Statement of Cash Flows - All Proprietary Fund Types. (The Statement of Cash Flows may be reported using the direct or indirect method of cash flows from operating activities. Although GASB encourages the use of the direct method of reporting cash flows from operations, entities may utilize the format considered to be most informative. The format chosen for the annual report of a county, city, or town is the Indirect Method.)

D. INTERNAL CONTROL

Assuring adequate internal control is fundamental and indispensable for all types of organizations. It can be defined in terms of two elements, administrative controls and accounting controls. Administrative controls are designed to encourage adherence to prescribed policies and accounting controls deal with safeguarding assets.

Both administrative and accounting controls are implemented primarily through:

? Developing specific written procedures that specify how activities and functions will be conducted.

? Segregating key control duties and responsibilities among different employees.

? Monitoring these procedures, duties and responsibilities to ensure conformance.

All local governments, including the TSEP recipient, are responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by the TSEP recipient are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of internal control are to provide the TSEP recipient with reasonable, but not absolute, assurance that assets are safeguarded against loss and that transactions are executed in accordance with the TSEP recipient's authorization.

In the financial management of TSEP funds, it is presumed that, at a minimum, the TSEP recipient will see that the work is properly segregated so that no one person is allowed to perform a complete cycle of operations. Where segregation of duties is not always possible because of staffing limitations, management should function in an oversight capacity. In such an event, the oversight provided should be as compensating as circumstances dictate.

The TSEP recipient's fiscal officer and local TSEP grant administrator should establish the internal control policies necessary to reduce the probability that errors or irregularities will occur in TSEP project funds.

The TSEP grant administrator, fiscal officer and other staff should discuss the division of responsibilities for the grant. Even though their responsibilities will be divided, the TSEP grant administrator and fiscal officer should be aware of the activities and expenditures occurring in each person's area of responsibility. A separation of duties should exist so that total control does not rest with one individual. This could be accomplished by:

? the fiscal officer and TSEP grant administrator having dual controls;

? claims being approved by the governing body and a listing included in the minutes; and

? checks/warrants signed by two authorized individuals.

Typically, the TSEP grant administrator will:

? review all expenditures through contracts, invoices and/or purchase orders;

? ensure proper coding of expenditures; and

? review and process payment requests for contractors.

Typically, the local fiscal officer and staff will:

? maintain records;

? prepare financial reports; and

? prepare checks/warrants for approved expenditures.

Several communities have developed forms to deal with the routine review and approval of bills, invoices, or other proposed expenditures by the grant administrator to assure that all expenditures are eligible and proper uses of TSEP funds. An example is included in Exhibit 4-E.

Internal control may not eliminate the probability that errors or irregularities will occur. But the probability of their occurrence can be reduced, if the TSEP recipient will put in place the proper administrative and accounting control policies and procedures.

E. ILLUSTRATIVE ACCOUNTING ENTRIES

The illustrative accounting entries that follow represent those most commonly associated with TSEP funds on a recurring basis. These illustrations are not intended to be all-inclusive, but they are intended to exhibit a cross-section of pertinent entries - without undue repetition. (Note: "Sub" is the abbreviation for subsidiary. It is the account detail that supports the general ledger control account.)

1. Public Facility Capital Projects Fund

   The County of XYZ applied for and was awarded a $100,000 grant for the construction of a new bridge. (Note: The County does not elect to capitalize the infrastructure fixed assets of governmental funds.)

   a. The first and only drawdown of the fiscal year was for $25,000.

   b. Of this amount, $24,000 was spent on construction costs in the fiscal year in which it was received.

   c. At year-end, the revenue and expenditure accounts were closed-out.

Related Accounting Entries		Debit	Credit	Sub
(a) 4300-101000	Cash	$25,000		
4300-172000	Revenue Control			$25,000
4300-334120	TSEP Grants/Loans			
$25,000				

(To record receipt of grant funds. Ordinarily, this entry would be recorded as part of the cash receipt process.)

Related Accounting Entries		Debit	Sub	Credit
(b) 4300-242000	Expenditure Control	$24,000		

4300-470440-9xxConstruction $24,000
4300-101000 Cash
$24,000
(To record payment of construction costs. Ordinarily, this entry would be recorded as part of the cash disbursement process.)

Related Accounting Entries		Debit	Credit
(c) 4300-172000	Revenue Control	$25,000	
4300-242000	Expenditure Control		$24,000
4300-271000	Fund Balance		$ 1,000

(To record year-end closing.)

2. Public Facility Enterprise Fund

a. The City of ABC applied for and was awarded a $500,000 grant for a sewer treatment plant.

(1) During the initial fiscal year, half of the grant was received.

(2) During the same period, half of the grant was spent for construction costs.

(3) At year-end, closing entries were made and the work in progress account established.

(4) During the following year, the remaining portion of the grant was drawn down and spent and the project completed. (Entries are not repeated.) The work in progress account balance of $500,000 was transferred to fixed assets.

Related Accounting Entries		Debit	Credit	Sub
(a) 5310-1021xx	Cash	$250,000		
5310-172000	Revenue Control		$250,000	
5310-334120	TSEP Grants/Loans			$250,000

(To record receipt of grant proceeds. Ordinarily, this entry would be recorded as a part of the cash receipts process.)

Related Accounting Entries		Debit	Sub	Credit
(b) 5310-242000	Expenditure Control	$250,000		

5310-470440-9xx	Construction	$250,000			
5310-1021xx	Cash			$250,000	

(To record payment of construction costs. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

Related Accounting Entries		Debit	Sub	Credit	Sub
(c) 5310-172000	Revenue Control	$250,000			
5310-334xxx	Grants/Loans		$250,000		
5310-2601xx	Contributed Capital			$250,000	
5310-188000	Work in Progress		$250,000		
5310-242000	Expenditure Control			$250,000	
5310-470440-9xx	Construction				$250,000

(To record year-end closing and work in progress. Ordinarily, this entry would be recorded by GJV.)

Related Accounting Entries		Debit	Credit
(d) 189xxx	Treatment Plant	$500,000	
188000	Work in Progress		$500,000

(To transfer work in progress to fixed assets.)

b. The Montana Water District applied for and was awarded a $10,000 loan for water engineering services.

(1) The $10,000 loan was received shortly after the loan agreement was signed.

(2) All but $500 of the loan was expensed for engineering services.

(3) At year-end, closing entries were made and the loan payable established.

(4) Eleven months after the loan agreement was signed, the TSEP recipient repaid the loan.

Related Accounting Entries		Debit	Credit	Sub
(a) 5210-1021xx	Cash	$10,000		
5210-172000	Revenue Control			$10,000
5210-334120	TSEP Grants/Loans			$10,000

(To record receipt of loan proceeds. Ordinarily, this entry would be recorded as a part of the cash receipts process.)

Related Accounting Entries		Debit	Sub	Credit
(b) 5210-242000	Expenditure Control	$9,500		
5210-470430-9xx	Engineering		$9,500	
5210-1021xxx	Cash			$9,500

(To record payment of engineering costs. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

Related Accounting Entries		Debit	Sub	Credit
(c) 5210-172000	Revenue Control	$10,000		
5210-331xxx	Grants/Loans		$10,000	
5210-204000	Loans Payable (short term)	$10,000		

(To record year-end closing entries and establish the loan payable. Ordinarily, this entry would be recorded by GJV.)

Related Accounting Entries		Debit	Credit
(d) 5210-204000	Loan Payable	$10,000	
5210-1021xx	Cash		$10,000

(To record repayment of loan. Ordinarily, this entry would be recorded as part of the cash disbursement process.)

F. AUDIT REQUIREMENTS

If federal funds, such as from the Community Development Block Grant (CDBG) Program, will be used to help fund a TSEP public facilities project, the federal audit requirements may also apply, depending upon the amount of federal awards expended during a fiscal year. The pertinent federal requirements are typically spelled out in the auditee's grant document and may also be found in the Catalog of Federal Domestic Assistance (CFDA) under that program's specific identification number. For CDBG funding being passed through the MDOC the CFDA number is 14.228. Because the pertinent federal audit requirements and procedures vary among federal agencies, the auditor will follow the guidance prescribed above as well as in the OMB Circular A-133 Compliance Supplement, which is updated annually, to audit the auditee's federal funds. If federal funds will be involved in your TSEP project, you should consult with the federal or state granting agency that is providing assistance for guidance on the audit requirements that will apply.

1. Federal - Laws and Regulations

a. **The Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996**, the principal federal audit statute, imposes no audit requirements on the TSEP recipient. The only audit requirements that are applicable to TSEP funds are those imposed by State law – see below.

b. **OMB Circular A-133**, Audits of States, Local Governments, and Non-Profit Organizations sets forth the regulations issued by the Office of Management and Budget (OMB) to implement the Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996. As required by the Act itself, a recipient is only required to have an audit in accordance with the requirements of this Circular if the recipient expends $300,000 or more in a year in federal awards. Because TSEP funding is 100% from the State of Montana these requirements are not applicable to the TSEP funding of a project.

c. **Government Auditing Standards** (referred to as the Yellow Book) contain generally accepted government auditing standards applicable to the TSEP recipient. Issued by the U.S. Comptroller General, these standards incorporate auditing standards generally accepted in the United States as adopted by the American Institute of Certified Public Accountants. Normally these standards would only apply if a local government entity was required to have an audit in accordance with the Single Audit Act and OMB Circular A-133. However, in Montana, the Department of Administration has adopted administrative rules that require that all audits of Montana local government entities conducted under the provisions of the Montana Single Audit Act (Title 2, Chapter 7, Part 5, MCA) be conducted in accordance with Government Auditing Standards that are applicable to financial audits.

2. <u>State - Laws and Regulations</u>

a. **Sections 2-7-501 through 2-7-522, MCA,** set forth the requirements for the audit of political subdivisions, referred to as the Montana Single Audit Act.

b. **ARM 2.4.401 through 2.4.411** set forth the regulations of the Montana Single Audit Act for Montana local government entities.

c. **MDOA's Compliance Supplement for Audits of Montana Local Government Entities** sets forth those legal compliance matters deemed most important to financial operations of political subdivisions.

3. <u>The Montana Single Audit Act</u>

The purpose of the Montana Single Audit Act is to:

a. Improve the financial management of local government entities with respect to federal, state, and local financial assistance;

b. Establish uniform requirements for financial reports and audits of local government entities;

c. Ensure constituent interests by determining that compliance with all appropriate statutes and regulations is accomplished;

d. Ensure that the financial condition and operations of the local government entities are reasonably conducted and reported;

e. Ensure that the stewardship of local government entities is conducted in a manner to preserve and protect the public trust;

f. Ensure that local government entities accomplish, with economy and efficiency, the duties and responsibilities of the entities in accordance with the legal requirements imposed and the desires of the public; and

g. Promote the efficient and effective use of audit resources.

4. Audit Threshold and Frequency

Section 2-7-503(3), MCA. The governing body or managing or executive officer of each local government entity receiving revenues or financial assistance in excess of $200,000 during the reporting period (1 year) shall cause an organization-wide audit to be made at least every 2 years.

The audit must cover the entity's two preceding fiscal years. The audit must commence within 9 months from the close of the last fiscal year of the audit period. The audit must be completed and submitted to MDOA for review within 1 year from the close of the last fiscal year covered by the audit.

5. Montana Single Audit Administrative Rule Requirements - ARM 2.4.401 through 2.4.411 (Note: In the following sections dealing with the Administrative Rule audit requirements, the word "department" refers to the Department of Administraion unless another department is specifically named.)

a. Audit and Audit Report Standards – ARM 2.4.405

(1) All audits performed under section 2-7-503, MCA, must be conducted in accordance with Government Auditing Standards, issued by the U.S. Comptroller General [see ARM 2.4.411(3)], that are applicable to financial audits. Those standards incorporate generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants.

(2) Audits must conform to the requirements of the Single Audit Act of 1984, as amended by the Single Audit Act Amendments of 1996, (P.L. 104-156) and the OMB Circular A-133 [see ARM 2.4.411(4)].

(3) All audit reports shall comply with the reporting standards for financial audits prescribed in Government Auditing Standards as established by the U.S. Comptroller General, which incorporate the standards of reporting for financial audits prescribed by the American Institute of Certified Public Accountants [see ARM 2.4.411(3)].

(4) For audits conducted under the provisions of the OMB Circular A-133, the audit

reports shall comply with the reporting requirements of that circular [see ARM 2.4.411(4)].

b. Roster of Independent Auditors Authorized to Conduct Audits of Local Government Entities – ARM 2.4.406

(1) An independent auditor, as defined by section 2-7-501(6), MCA, must conduct local government entity audits under the provisions of Title 2, chapter 7, part 5, MCA. For purposes of this requirement, an "independent auditor" is a federal, state, or local government auditor who meets the standards specified in Government Auditing Standards as established by the U.S. Comptroller General; or a licensed accountant who meets the standards specified in Government Auditing Standards as established by the U.S. Comptroller General [see ARM 2.4.411(3)].

(2) In order to conduct audits of local government entities, an independent auditor must be on the roster of independent auditors, authorized to conduct such audits, that is maintained by the Department.

(3) In order to be placed on the roster, independent auditors must complete an application form prescribed by the Department and meet the criteria set out in this section.

(4) Independent auditors with separate offices registered as required by section 37-50-335, MCA, must submit separate application forms for each office that is to be placed on the roster.

(5) To be eligible for inclusion on the roster, an independent auditor must meet the requirements of section 37-50-335, MCA and ARM 2.4.406.

(a) if an individual, hold a current Montana certificate as a certified public accountant and hold a current annual permit to engage in the practice of public accounting under section 37-50-314, MCA, or hold a current license as a licensed public accountant, have been licensed on or before December 31, 1970, and hold a current annual permit to engage in the practice of public accounting under section 37-50-314, MCA;

(b) if a partnership or corporation, be currently registered as a partnership of certified public accountants or a corporation of certified public accountants, or be currently registered as a partnership of licensed public accountants or a corporation of licensed public accountants, and have been registered on or before December 31, 1970 (section 37-50-335);

(c) meet the continuing education requirements specified in Government Auditing Standards, as established by the U.S. Comptroller General;

(d) have an external quality control review at least once every 3 years that meets the requirements specified in Government Auditing Standards, as established by the U.S. Comptroller General, and receive an unqualified review report from the reviewing firm, team or association;

(e) not have been restricted in the conduct of governmental auditing by the Montana Board of Public Accountants;

(f) not have been debarred, suspended, proposed for debarment, declared ineligible, or otherwise excluded from performing audits by any state or federal department or agency;

(g) not have been deemed ineligible to conduct local government entity audits by the Department:

(i) because of failure to conduct local government entity audits under contract with the Department during the previous two years in accordance with the audit standards described in ARM 2.4.405,

(ii) because of failure during the previous two years to adhere to the terms and conditions of an audit contract with the Department, or

(iii) because the independent auditor is more than 90 days delinquent in filing an audit report required under an existing contract with the Department and has not obtained the Department's written consent to an extension of the contracted filing date.

(6) An independent auditor may be removed by the Department from the roster of independent auditors authorized to conduct audits of local government entities for failure to continue to meet the eligibility requirements specified above.

(7) If an independent auditor is removed by the department from the roster as provided in (6) above, the independent auditor must complete the application form prescribed by the Department, meet the eligibility requirements set out in (5) above, and pay the fee specified in (10) below in order to again be placed on the roster.

(8) To remain on the roster, an independent auditor must complete and submit to the Department on or before June 30 of each year a renewal form prescribed by the Department on which the independent auditor certifies that the individual, partnership or corporation continues to meet the eligibility requirements specified above.

(9) To ensure that each independent auditor meets the eligibility requirements specified above, the Department may, at any other time during the year, require the independent auditor to submit to the department evidence that the independent auditor meets the above eligibility requirements, including but not limited to documentation of required continuing professional education and the required external quality control review.

(10) At the time of original application to the department for placement on the roster, and at the time the annual renewal form is submitted to the Department, each independent auditor, including each office, shall pay to the Department a fee of $50.00.

(11) If an independent auditor is removed from the roster, or if an independent auditor does not properly renew for continuance on the roster, any and all contracts for local government entity audits entered into under the provisions of section 2-7-506, MCA, to which the independent auditor is a party are terminated, and the Department will notify the local government entities of the termination. If an independent auditor is removed from the roster, the Department will not refund any portion of the fee paid to the Department by that independent auditor for placement on the roster.

(12) Upon notification of the termination of a contract for a local government entity audit, the local government entity must select another independent auditor from the Department's roster of independent auditors authorized to conduct local government audits and present a signed contract to the Department for approval within 90 days of notification of the termination.

(13) Upon termination of a contract for a local government entity audit, if the local government entity fails to present a signed contract to the department for approval with the 90 day period in (12) above, the Department will designate an independent auditor to perform the audit as provided by section 2-7-506(5), MCA.

c. Criteria for the Selection of the Independent Auditor – ARM 2.4.407

(1) In selecting an independent auditor to perform an audit under section 2-7-503,

MCA, a local government entity shall consider the following criteria:

(a) listing on Department's roster of independent auditors authorized to conduct local government audits;

(b) independence, as defined by applicable auditing standards;

(c) demonstrated understanding of the work to be performed;

(d) technical experience of the independent auditor in conducting similar types of local government entity audits;

(e) qualifications of staff to be assigned to the audit;

(f) work history of the independent auditor; and

(g) the proposed audit fee.

(2) The Department may require the local government entity to demonstrate that the independent auditor selected is qualified to conduct the audit based on an evaluation of:

(a) the criteria established in (1) above;

(b) any additional information requested by and used by the local government entity in selecting the independent auditor; and

(c) the results of oral interviews of independent auditors conducted by the local government entity, if appropriate.

d. Audit Contracts – ARM 2.4.408

(1) As provided by section 2-7-506(3), MCA, an audit of a local government entity by an independent auditor must be pursuant to a contract entered into by the governing body or managing or executive officer of the local government and the independent auditor.

(2) The Department must be a party to the contract, and work under the contract may not commence until the department signs the contract.

(3) All contracts for conducting audits must be in a form prescribed by the Department.

(4) The Department will not enter into a contract in which the independent auditor and local government entity have not provided all of the information required by the contract form.

(5) The Department will not enter into an audit contract covering more than three consecutive fiscal years.

6. Audit Costs

Some TSEP recipients include funds in their TSEP project budget to cover all or a portion of the audit costs. The cost of paying the TSEP share of an audit is an eligible TSEP expense. The percentage of the total audit costs that should be charged to the TSEP project should be proportional to the percentage of TSEP funds that are received and/or expended as compared to the recipient’s total funds that are received and/or expended during the audit period. After all other project activities are completed, any other unexpended TSEP funds from the balance remaining will be reserved by MDOC to cover the TSEP project's share of audit costs, or in the event that a project-specific audit is conducted, the direct costs of the audit.

CHAPTER 4

EXHIBITS

4-A Sample Budgetary Authority Resolution

4-B Request for Funds Form and Instructions

4-C TSEP Project Progress Report Format

4-D Sample TSEP Project Progress Report

4-E Sample Expenditure Review Form

4-F Checklist for Submittal of Request for Funds

4-G Uniform Status of Funds Spreadsheet and Instructions

4-H Sample Uniform Status of Funds Spreadsheet

4-I Uniform Invoice Tracking Spreadsheet and Instructions

4-J Sample Uniform Invoice Tracking Spreadsheet

4-K Certification of Labor Compliance